In The

Supreme Court of the United States

October Term 1977

NO. 77-15

E. B. BROOKS, JR.,

Petitioner,

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF FOR RESPONDENT IN OPPOSITION

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TO THE HONORABLE CHIEF JUSTICE OF THE UNITED STATES AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Respondent, Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") respectfully prays that Writ of Certiorari be denied herein. The decision of the Fifth Circuit is correct and, in addition, this case presents no "special and important reasons" for granting review.

QUESTIONS PRESENTED

1. Was Merrill Lynch under any legal duty whatsoever to liquidate Brooks' commodity position once (or within a reasonable time after) his account became undermargined by virtue of any provisions of the Commodity Exchange Act, rules or regulations of the Chicago Board of Trade, or of the Commodity Account Agreement between the parties?

2. What is the legal effect of the fact finding that Brooks "consented" to the manner in which Merrill Lynch handled his account by his acquiescence and by his execution of the May 7, 1973, letter, acknowledging his indebtedness to Merrill Lynch?

3. Was reversible error committed by the trial court in allegedly failing to submit material fact issues to the jury?

STATEMENT OF THE CASE

A. Nature and Disposition of the Case

This diversity action was brought by Merrill Lynch to recover the balance due in Brooks' commodity account. Brooks defended and counterclaimed, asserting that Merrill Lynch was negligent and/or breached its contractual and fiduciary duties to Brooks in certain particulars and that such negligence and/or breaches caused Brooks to have a debit, rather than a credit, balance upon the closing of his account. Brooks also sought affirmative relief on various theories that Merrill Lynch allegedly violated federal and state antitrust laws. However, Brooks did not appeal from the denial of relief on his counterclaims (Petition for Writ of Certiorari at 7).

The case was tried to a jury and resulted in a Judgment against Brooks for $198,262, plus prejudgment interest at

seven and one-half percent (7½%) per annum from May 11, 1973, to the date of Judgment, December 11, 1975, and post-judgment interest at nine percent (9%) per annum.

B. The Evidence

In 1964 Brooks first opened a commodity trading account with Merrill Lynch (Tp. 354).[1] On or about June 19, 1969, Brooks executed a Commodity Account Agreement, wherein as consideration for Merrill Lynch's acting as his broker in the buying and selling of commodity futures contracts, Brooks agreed to certain terms which would govern the relationship (Tp. 202; Px-1).[2] In early April 1973, Brooks held a short position in twenty-four (24) July 1973 Soybean Meal futures contracts, which were trading on the Chicago Board of Trade ("CBT") (Tp. 43-46; Px-9). A "short" position is established by the customer's instructing the commodity broker to "sell short," or acquire a contract to sell a commodity for future delivery without actually owning the commodity (Tp. 17-18). A speculator, such as Brooks, who sells short in a particular commodity contract hopes that the price of the contract will decrease, so that he can liquidate his position (or "cover") by buying a contract for delivery (satisfying his obligation to sell) at a lower price and thereby realize a profit (Tp. 18). All that a speculator is required to deposit with the commodity exchange (through his broker) in order to establish a commodity position is a small percentage of the total price of the commodity contract on the day the position is acquired (Tp. 59-60). This percentage is known as "initial margin." Although

[1] "Tp." citations are to the Transcript of Proceedings in the Trial Court.

[2] "Px." or "Dx" citations are to the exhibits admitted into evidence by the Trial Court.

Brooks had paid the initial margin required to hold a short position in his July 1973 Soybean Meal contract, on April 12, 1973, because of an increase in the contract price, he was required to deposit additional margin money with Merrill Lynch. This additional margin is called "maintenance margin." Because of some computer error or other error, no formal "margin call," or notice that additional margin is due, was given to Brooks by Merrill Lynch at that time (Tp. 137-39). However, Brooks was fully aware at all times from April 12, 1973, through May 9 and 11, 1973, of the extent to which his commodity account was undermargined (Tp. 188-89, 190, 204-06, 371). He was further aware, having previously deposited maintenance margins for other commodities contracts, that once an account becomes undermargined, the customer must either meet the maintenance margin requirement or liquidate his position (Tp. 70, 197-200, 370). Yet, on May 1, 1973, when the manager of the Dallas-Republic office of Merrill Lynch, N. R. Davis ("Davis"), formally requested Brooks to deposit the required maintenance margin, Brooks asked Merrill Lynch not to liquidate his account and sought additional time within which to make satisfactory arrangements to secure the required maintenance margin (Tp. 201, 203, 377). On May 2, 1973, Brooks orally agreed that he was indebted to Merrill Lynch in a then undetermined amount, being the ultimate difference between the price of 1973 Soybean Meal contracts at the date of liquidation of Brooks' account and the contract equity and margin deposits in Brooks' account (Tp. 52). On May 7, 1973, Brooks evidenced these oral agreements by executing, before a Notary Public, a letter to N. R. Davis, fully setting forth such agreements in writing (Tp. 202).

When Brooks failed to cover his short position, deposit the maintenance margin, or to make any other satisfactory arrangements to put his account in order, Merrill Lynch began to attempt to buy the necessary contracts for the delivery of July 1973 soybean meal to liquidate Brooks' account. Although the market was disorderly, from May 9 through May 11, 1973, Merrill Lynch was able to buy in twenty-four (24) 1973 July Soybean Meal contracts to cover Brooks' short position and liquidate his account, resulting in an unpaid balance of $198,262.00.

REASONS FOR DENYING THE WRIT

Other than simply contending that the decisions of the Trial Court and the Court of Appeals are wrong on the facts of this case, Brooks asserts that the Writ of Certiorari should be granted because: (1) the case involves important questions concerning the applicability of the Commodity Exchange Act, 7 U.S.C. §§ 1-17a (1970) ("CEA"); and (2) the refusal of the courts below to consider that an alleged violation of a Rule 210 of the CBT by a futures commission merchant (or commodities broker) could give its customer a defense to the broker's suit for the deficit balance in the customer's account is somehow in conflict with decisions of this Court and the Second, Seventh and Eighth Circuits. Although it is submitted that the decisions below are eminently correct, nevertheless Merrill Lynch must dispute Brooks' assertion of the "certworthiness" of this case.

1. *No Question of Federal Law Involved.* This case does not involve the CEA or rules or regulations of the Commodity Exchange Commission. True, Brooks' soybean meal futures contracts were traded on the CBT, which was a "contract mar-

ket" designated by Secretary of Agriculture. Pursuant to 7 U.S.C. § 6 (1970), trading in future contracts on a market not so designated by the Secretary of Agriculture would have been unlawful in itself. However, the CBT is not a government agency, but rather a private corporation specially chartered by the State of Illinois. *See Daniel v. Board of Trade of the City of Chicago,* 164 F.2d 815 (7th Cir. 1947). Of course, members of the CBT, such as Merrill Lynch, are indeed bound *to the CBT* to abide by its bylaws, rules and regulations. *See Miller v. New York Produce Exchange,* 550 F.2d 762 (2d Cir. 1977). Brooks has never argued that Merrill Lynch violated specific provisions of the CEA or rules and regulations of the Commodity Exchange Commission. He has only argued that Merrill Lynch violated CBT Rule 210 by carrying Brooks' account for a period of time in an undermargined condition. CBT Rule 210 is neither a statute of the United States nor a rule or regulation of a government agency. Furthermore, even after the Commodity Futures Trading Commission Act of 1974 ("CFTCA"), which significantly broadened federal regulation of commodity futures trading and contract markets (the CEA being considered too weak), no federal law or regulation attempts to regulate margin requirements in commodity futures transactions. And even after the CFTCA (effective long after the transactions at issue and, therefore, not controlling herein) no statutory duty is placed on the *futures commission merchant* (broker) to obey the rules of the various exchanges, although the Commodity Futures Trading Commission may take action against an *exchange* if it is too lax in the enforcement of its own rules. 7 U.S.C. § 21(*1*)(1) (Supp. 1974). Although in 1974 with the CFTCA Congress infringed somewhat upon the self-regulatory status of the commodity ex-

changes, nevertheless it expressly exempted from the provisions of the CFTCA requiring Commission review and approval of exchange rules those rules "relating to the setting of levels of margin." 7 U.S.C. §§ 7a(12) and 8a(7)(C) (Supp. 1974). Also, margin rules of the exchanges are not included in the CFTCA provisions which require the exchanges to strictly enforce their own bylaws, rules, and regulations. 7 U.S.C. § 7a(8) (Supp. 1974). *A fortiori* there was no federal regulation of commodity futures margins prior to the effective date of CFTCA. Therefore, no federal law has applicability to this case. This is simply a diversity case involving New York and/or Texas law.

2. *The Decision Below is Not in Conflict With Decisions of This Court or Other Courts of Appeals.* Brooks asserts that the decision of the Fifth Circuit herein is in conflict with *Ricci v. Chicago Mercantile Exchange,* 409 U.S. 289 (1973), *Miller v. New York Produce Exchange, supra, Daniel v. Board of Trade of the City of Chicago, supra, Cargill, Inc. v. Board of Trade of the City of Chicago,* 164 F.2d 820 (7th Cir. 1974), *Case & Co. v. Board of Trade of the City of Chicago,* 523 F.2d 355 (7th Cir. 1975), and *Cargill, Inc. v. Hardin,* 452 F.2d 1154 (8th Cir. 1971). The truth is that none of these decisions dealt with the holding of the Fifth Circuit in the case at bar — *i.e.*, even assuming a violation of a Commodity exchange margin rule by a broker, the broker's customer is still liable for the deficit balance in his account upon liquidation. None of the decisions cited as "conflicting" by Brooks arose out of suits between Commodity broker and customer. Obviously then, none were concerned with duties owed by the broker and its customer, one to the other. There is, quite simply, no conflict with any federal decision. Further, as will

be shown below, the decisions of the Trial Court and the Fifth Circuit are in harmony with every commodities decision handed down by state courts on the relevant issue. Accordingly, certiorari cannot be based upon a conflict between circuits or with a decision of this Court. *See Keller v. Adams-Campbell Co.*, 264 U.S. 314 (1924).

3. *There Exists no "Special or Important Reason" for Granting the Writ.* Even assuming arguendo that there exists authority tending to support Brooks' contention that Merrill Lynch's alleged violation of a commodity exchange rule "would ordinarily" provide a customer with a defense, certiorari should not be granted because: (1) the evidence and jury and Trial Court findings conclusively demonstrate that Brooks consented or ratified any alleged improper conduct of Merrill Lynch; and (2) the evidence and applicable law (including the Commodity Account Agreement) establish that CBT Rule 210 was not promulgated for the protection of the customer and that other CBT rules and the Commodity Account Agreement provide that the customer shall be liable for his deficit balance notwithstanding an alleged violation of CBT Rule 210. Thus, whichever way the so-called "conflict" might be resolved, the decisions below are sustainable on independent, alternative non-federal grounds and certiorari is not justified. *See The Monrosa v. Carbon Black, Inc.*, 359 U.S. 180 (1959). Further, if, and to the extent Brooks' position may be dependent upon or at all enhanced by the CFTCA (passed and effective after the occurrence of the transactions at issue herein), certiorari is not called for because the applicable law (the CEA as amended in 1968) is no longer the law of the land. Finally, complaints asserted by Brooks regarding specific evidence, fact findings, and special verdict submission, even if valid (and they are

not), would not justify certiorari. *See United States v. Johnston*, 268 U.S. 220, 227 (1925).

ARGUMENT

1. Merrill Lynch is Not Precluded from Recovering Against Brooks Because of its Failure to Liquidate Brooks' Account Prior to May 9 and 11, 1973

Brooks vigorously argues that the failure of Merrill Lynch to give him a formal margin call prior to May 2, 1973, and its maintenance of his account in an undermargined condition, or failure to liquidate his short position in 1973 Soybean Meal contracts prior to May 9 and 11, 1973, was: (1) negligence (as found by the jury) (R. 177)[3]; (2) a violation of CBT Rule 210, which provides in pertinent part that "No member may accept or carry an account for a customer . . . without proper and adequate margin"; (3) a breach of the Commodity Account Agreement; and/or (4) a breach of fiduciary duties owed to Brooks. Brooks contends that the negligence and proximate cause findings of the jury, the breaches of contractual and fiduciary duties, and the violations of CBT rules and regulations singularly or collectively bar Merrill Lynch from recovering the debit balance remaining in Brooks' commodity account after its liquidation by Merrill Lynch upon Brooks' failure to deposit the required maintenance margin. The following argument will establish that even if Brooks is correct in contending that Merrill Lynch breached legal duties owed to Brooks, under New York law, CBT rules and regulations, and the Commodity Account Agreement, Merrill Lynch is not precluded from recovering the debit balance. Of course, it is

[3]"R." citations are to the record on appeal in the Fifth Circuit.

not admitted that Merrill Lynch breached any duties *owed to Brooks.*

A. Violations of Commodity Exchange Rules Provide No Defense for Brooks

Under the law of New York a violation of a rule of an exchange by a stockbroker or commodities broker not only does not subject the broker to civil liability, but does not provide a defense by the customer to the broker's suit for debt. In *Nichols & Co. v. Columbus Credit Corp.*, 204 Misc. 848, 126 N.Y.S.2d 715 (Sup. Ct. 1953), the commodity broker brought an action to recover the balance due on a customer's account, and the customer defended the broker's action and counterclaimed for damages on the theory that the broker violated Rule 30(a) of the Cotton Exchange by permitting his account to remain undermargined for 20 days. The customer further defended and counterclaimed on the basis that the broker violated Rule 30 of the Cotton Exchange by extending credit to the customer. The court, in directing a judgment in favor of the broker, explained as follows:

> Assuming arguendo that the under-margining was such that the rule required restoration and a closing of the account upon Defendant's failure to restore, and also assuming that Plaintiff failed to take such steps that it reasonably could take in order to get Defendant to restore the impaired margin, I am of the opinion that a violation of the rule by Plaintiff by failing to restore the margin does not entitle Defendant to recover of Plaintiff such loss as Defendant may have sustained by reason of further market fluctuations after the account would have been closed if the rule had been complied with.
>
> Not every violation of even a statutory command or prohibition gives rise to civil liability to one harmed

> by the violation *or carries with it as a penalty an inability to enforce civil rights arising from acts which would have been lawful except for the statute; and a fortori mere violation of a rule of an exchange does not give rise to such civil liability or entail inability to enforce civil rights*

Id. at 717-18 (emphasis added). Although having already disposed of the customer's counterclaims *and defenses,* the court felt compelled to comment further on the right of a customer to complain of a broker's actions or omissions in such circumstances:

> [A] broker who persistently and intentionally is too indulgent with a customer in respect of margins doubtless will find himself in trouble with public authorities charged with the duty of enforcing such statutes and regulation or with the governing body of his exchange charged with the duty of enforcing the rules of such an exchange; but it seems to me clear that the mere failure of a broker to enforce, strictly and instantly, a margin requirement which the rules of his exchange entitle him to enforce against his customer does not give the customer a cause of action against the broker. The customer is the one who is speculating, not the broker. The customer has the strong financial incentive to watch market fluctuations, and there is no suggestion that he lacks the facilities for keeping himself advised as to them. It also is easy for the customer to protect himself by giving an order to buy or sell when the market reaches a stated point; and I hence think that the customer is the last person in the world who should be heard to complain that his broker has not been sufficiently exacting and stringent in requiring margin.

Id. at 719.

A California case, *DuPont v. Neiman*, 156 Cal. App. 2d 313, 319 P.2d 60, 66 (1957), also holds that a commodities broker

is not precluded from recovering a debit balance in its customer's account, even if it is assumed that the brokers "carried" such account in an undermargined condition prior to liquidation and thereby violated the CBT's rules and regulations:

> We know of no rule of law in this state which would permit a wrongdoer to disaffirm a loss brought on by his own iniquity [failure to pay maintenance margin] unless there be a violation of law involved. Nor is there any law in this state which makes the violation of a rule of an 'exchange' in granting credit to a broker's customer an 'illegal' transaction. It is neither *malum prohibitum* nor *malum in se*. It is manifest that the rules of a trading exchange cannot have the effect of a statutory enactment, and therefore cannot of their own force inject illegality into a transaction.

The rule at issue in *DuPont* was Rule 210 of the CBT. It is submitted that New York courts would concur with the holding and reasoning of *DuPont*.

Another case that stands for the proposition that a broker's failure to enforce margin requirements of an exchange will not prohibit it from recovering the debit balance of the customer is *Goodbody & Co. v. Penjaska*, 8 Mich. App. 64, 153 N.W.2d 665 (1967). Although this is a Michigan case, the law relied upon is predominantly that of New York. In addition, the facts of the case are so strikingly similar to those of the case at bar (although it is a securities, not a commodity futures, case) that its holding and reasoning must be regarded as extremely persuasive herein. In *Goodbody* the broker brought suit against its customer for the debit balance remaining in the customer's undermargined account following its liquidation by the broker. On February 24, 1959, Penjaska began to purchase through Goodbody blocks of Studebaker-Packard stock on margin. The

last block was purchased on January 26, 1960. The stock was highly speculative, and Penjaska made his own decisions as to the purchases and did not rely upon the advice of Goodbody. Beginning with February 3, 1960, the account needed margin, but no margin call was made by Goodbody. The stock continued to decline in value and on March 8, 1960, Goodbody called on Penjaska for $8,500 which Penjaska did not pay. In disallowing Penjaska's *defense* and counterclaim and rendering judgment for Goodbody, the court stated:

> The Defendants maintain in their counterclaim that they suffered damages because they were not sold out sooner. They claim that because Plaintiff violated certain rules of the New York Stock Exchange, that it may not recover in this action. In effect, they say because Plaintiff did not adhere strictly to the rules of the New York Stock Exchange as to margin, that it may not recover. Admittedly, on March 8, 1960, they asked for further time. Admittedly, they were in the office of Plaintiff almost every day, and admittedly they were familiar with the market. At no time did they demand that their stock be sold. Certainly they had as great a duty to protect their account as did the Plaintiff. They did not complain because the Plaintiff was lenient. I doubt if complaint would have been made had the price of the stock advanced during the period of leniency. Had the stock not been sold on March 29, their loss would have been greater. The Defendants are confused by the rules promulgated by the Securities and Exchange Commission and those promulgated by the New York Stock Exchange. There is a vast difference.

Id. at 666-67.

It is submitted that on the basis of the foregoing authorities, Brooks has no defense to Merrill Lynch's suit based on an alleged violation of Rule 210 of the Chicago Board of Trade.

Further, the *Goodbody* case is authority directly in point that the failure to enforce maintenance margin requirements on facts similar to the case at bar does not preclude a broker from recovering the customer's debit balance.

B. Merrill Lynch Was Under No Duty Whatsoever To Liquidate Brooks' Account At Any Time

The jury, in answer to Questions 1, 2, and 3, found that Merrill Lynch was negligent in maintaining Brooks' account in an undermargined condition beyond April 16, 1973, and that such negligence was a proximate cause of the losses in Brooks' account (R. 177-79). Brooks contends that the Trial Court should have entered a take-nothing judgment on Merrill Lynch's claim for debt because of these jury findings. In essence, Brooks is contending that Merrill Lynch's maintenance of his undermargined account after April 16, 1973, or Merrill Lynch's failure to liquidate his account by such date, violated CBT rules and regulations, was negligence, and constituted a breach of contract and fiduciary duty. However, it is the law of New York that a broker is under absolutely no duty to liquidate a customer's undermargined account, although the broker has a right to do so. Before examining the case authority on this issue, the express provisions in the Commodity Account Agreement dealing with this point should be considered as well as CBT Rule 209 and Regulation 1822, which deal with the rights and duties of a broker with regard to its customers' undermargined accounts. The Commodity Account Agreement provides in pertinent part:

> You [Merrill Lynch] shall have the right, *whenever in your discretion* you consider it necessary for your protection, . . . to sell any or all commodities in my [Brooks'] account(s) (either individually or jointly with others) to buy any or all commodities which my be short in such account(s) and to close any or all outstanding contracts, all without demand for margin or additional margin, notice of sale or purchase, or other notice or advertisement, and any such sales or purchases may be made at your [Merrill Lynch's] discretion on any exchange or other market where such business is then usually transacted and on any such sale you may be the purchaser for your own account; it being understood that a prior demand, or call or prior notice of the time and place of such sale and purchase shall not be considered a waiver of your right to sell or to buy without demand or notice as herein provided; *and it being further understood that I shall at all times be liable for the amount of any debit balance owing in my account(s) with you upon demand, and that I shall be liable for any deficiency remaining in any such account(s) in the event of the liquidation thereof in whole or in part by you or by me.*

Rule 209 of the CBT provides in pertinent part:

> 209. *Deposits by Customers.*—A member acting as commission merchant for a customer (member or non-member) may require from such customer a deposit, as indemnity against liability, and subsequent deposits to the extent of any adverse fluctuations in the market price. Such deposits must be made with the commission merchant within a reasonable time after demand, and, in the absence of unusual circumstances, one hour shall be deemed a reasonable time. The failure of the customer to make such deposit within such time, shall entitle, *but shall not obligate*, the commission merchant to close out the trades of the defaulting customer. (Emphasis added.)

Paragraph 14 of CBT Regulation 1822 provides in pertinent part:

> When a customer's account drops below the maintenance margin level, the account must be brought back to initial margin requirements. *The failure of a member to close the customer's account before it results in such deficit or undermargined condition shall not relieve the customer of any liability to the member.* . . . (Emphasis added.)

If there is any doubt as to the effect of these provisions, the opinion in *DuPont v. Neiman* is instructive:

> We must first examine the rules of the exchange in order to determine whether there have been violations thereof. Rule 209 of the Chicago Board of Trade, which relates to the duty of the broker to require initial and subsequent margin deposits, provides in part: 'The failure of the customer to make such deposit within such time, shall entitle, but shall not obligate, the commodity merchant to close out the trades of the defaulting customer.' While this rule gave plaintiffs [brokers] the right to close out defendant's account when he failed to meet margin calls in full, it did not require such action. See Jacobs v. Hyman, 5th Cir., 286 F. 346,351. The discretionary character of this provision clearly indicates that the failure of plaintiffs immediately to close out defendant's accounts when he began to pay less than plaintiffs demanded was not a violation of the rule.
>
> . . . . It is clear from [the language of Regulation 1822, paragraph 14] that the failure of the broker promptly to close the account of a delinquent customer does not affect the latter's liability nor the former's right to recover any deficiency on the account.

319 P.2d at 63.

Thus, the specific language of the Commodity Account Agreement, CBT Rule 209, and Regulation 1822 make it plain that there is no obligation upon the broker to close out a customer's undermargined account.

Even if Merrill Lynch owed a duty *to the CBT* not to carry a customer's account without proper and adequate margin (Rule 210), other CBT rules and regulations could not be clearer in rendering such customer liable for any debit balance remaining after liquidation. Therefore, *the rules and regulations of the CBT themselves* show that the undermargined customer may not take advantage of a lenient broker.

Even if the case law were to the contrary, the rule, regulation, and contract provision would control the relation between the parties on this issue. However, the case authority is in harmony with the rule, regulation, and contract. In *Rubin v. Salomon*, 136 Misc. 527, 241 N.Y.S. 495 (Mun. Ct. 1930), a pre-Regulation "T" securities case, the customer sued the broker for damages for the broker's failure to liquidate the customer's margin account. The customer claimed that the broker by telegram had demanded that the customer make an additional margin payment with the warning that if the margin was not forthcoming, the broker would sell the customer's stock the next day at a certain hour. The customer did not make the margin payment, but the brokers also did not sell the customer's stock as they had a right to do and as they had threatened to do. The customer claimed that the broker's failure to sell the stock caused his loss to be in excess of that which it would otherwise have been had the broker made the sale at the time specified. The court observed that:

> [Customer] makes no claim that he at any time instructed or gave defendants an order to sell the securities. This, of course, he could have done. Can plaintiff insist that his silence shall be construed as an order to sell? I think not. Defendants were under no legal duty to exercise its right to sell the stocks on default of their reasonable request for additional

margin at the time and place contemplated by their notice. They might treat plaintiff's silence as a willingness to have his account carried further in the hope that the market might improve.

A fiduciary relation exists between the broker and the customer. The notice of the brokers' intention to sell is given solely for their benefit. When the brokers do not sell, and choose to rely upon the personal responsibility of the customer, the latter is in no position to complain. The stock is the customer's stock, and is at all times subject to his order prior to redemption or sale. He benefits by any increase in price. He also, necessarily, assumes the risk of depreciation or loss. Should the broker undertake to sell immediately, there is often the question of reasonableness of notice. The broker is not compelled to sell at his peril. For the customer retains the right to order a sale, and the broker must obey the reasonable instructions of the customer, qualified, however, by the rule that a pledgee need not comply with the pledgor's request that he sell the pledged property provided that the refusal to sell is the result of the exercise of the pledgee's honest judgment. . . . These duties and obligations are inherent in the relationship of the parties.

A customer who purchases securities on margin through a stock broker becomes a general owner of the securities, and the broker is only a pledgee for the advances which he makes for the customer's account. The risk of the venture in the purchase of stock on margin is borne entirely by the customer. The customer is under a duty to take and pay for the stock or put up additional margin whenever reasonably requested so to do by the broker. Failing to do this, the broker may sell after a demand for margin is not complied with and notice of intended sale has been given. *The broker is not compelled, however to sell when the margin is exhausted. He may continue to hold the security for the account and at the risk of the customer notwithstanding the customer's failure to comply with the demand for additional margin.* The broker may thus rely on the credit of the customer who is the owner of the securities and liable for the purchaser price thereof. . . .

In Dos Passos on "Stockbrokers and Stock Exchanges," the author pays (at page 350): 'after the pledgee, however, has called upon the pledgor to pay the debt, and has given legal notice of sale, he is not bound to proceed and sell the same. . . . The rule is that a pledgee of stock or securities is under no obligation to sell the security after default in payment of the debt.'

Id. at 496-97 (emphasis added). The court then noted that the customer's counsel was unable to find any authority for his argument. Counsel did, however, argue that the brokers in this case should be held to a duty to sell, since their demand for margin set forth a certain time and date for the sale of the stock if the margin money was not forthcoming. The Court held that these facts did not justify a change in the established rule:

> Plaintiff overlooks the fact that the notice by the stockbroker may well be considered as having been given for his own benefit and protection, and that he may waive his right to sell immediately. If the broker fails to sell at the appointed time or place, the broker may later give the customer notice of sale at another time and place; and, *in the absence of some order or instruction by the customer*, the customer is in no position to complain.

Id. at 498. The court concluded its opinion, saying that: "By his silence a customer may not take advantage of a fluctuating market at the expense of the broker, and thereafter claim that he had repudiated only if the market improved." *Id.* at 499.

Other pre-Regulation "T" New York securities cases which hold that the broker is under no duty to liquidate his customer's

undermargined account include *Crowell v. Cohen*, 151 Misc. 242, 271 N.Y.S. 285 (Sup. Ct. 1934); *Little v. McClain*, 118 N.Y.S. 916, 919 (App. Div. 1909). A Louisiana case provides further authority on this point. In *Kohlmeyer & Co. v. Sobert*, 273 So.2d 884, 886 (La. App. 1973), a commodity futures case, the court stated that:

> Sobert further contends that his broker should have taken action to minimize the substantial losses he incurred over and above the amount that was contained in his margin account. The trial court apparently found this contention equally fallacious and we find no manifest error in this conclusion. No evidence was produced nor have we been cited any authority that would impose a duty upon the broker to take any specified action in an attempt to minimize the customer's losses under the circumstances in this case. The cases cited to us by appellant to support his position. . . are distinguished by the fact that the customer had given his broker specific instructions for actions to be taken not to incur losses in excess of the margin on his account. The record supports the conclusion that no such instructions were given in this case.

In *Pistell, Deans & Co. v. Obletz*, 232 App. Div. 313, 249 N.Y.S. 616 (Sup. Ct. 1931), the court had charged the jury that it was the duty of the broker to have sold the stock of his undermargined customer within a reasonable time after the customer's default. (It is noted that the Trial Court in the case at bar submitted negligence issues essentially inquiring as to Merrill Lynch's reasonableness, or lack thereof, in failing to liquidate prior to May 9 and 11, 1973.) The appellate court reversed, and clearly stated that the broker's discretion in dealing with the customer's margin is not so limited:

> It is not claimed that the Defendant [customer] at any time ordered the Plaintiff [broker] to sell the stock. We need not consider what the rights and obligations would be in case of such an order. . . . *The Plaintiff, under the facts in this record owed no duty to the Defendant to sell the stock at any* time. The Plaintiff's right as a creditor and pledgor, as we have already stated, was to hold the stock until it was paid in full or if it saw fit to realize upon the sale of the stock thus held as security, to sell it after reasonable notice to the Defendant. *The Plaintiff's right and obligations under the facts in this case had nothing to do with the sale of the stock within a reasonable time.*

Id. at 621 (emphasis added). In this connection, it is well to note that the Commodity Account Agreement states: "Any and all commodities or contracts relating thereto, now or hereafter held or carried by you [Merrill Lynch] for me [Brooks], . . . are to be held by you as security for the payment of any liability of mine to you." The *Obletz* case is authority that in New York it is reversible error for a trial court to submit negligence issues similar to those submitted in this case, because the broker has *no duty whatsoever* to liquidate an undermargined account.

Therefore, the case law independent of the contract involved in this case, and independent of CBT Rule 209 and Regulation 1822, clearly holds that in the absence of an express stop-loss order requested by the customer, the broker is under no duty to liquidate the customer's account once it becomes undermargined, but instead may look to the personal financial responsibility of the customer. At all times the risk of loss in the account is on the customer. The right to liquidate for one's own protection cannot be translated into a duty to liquidate. The facility to minimize losses was well within the grasp of Brooks in this case, but he refused to enter stop-loss orders. Brooks never specifically requested Merrill Lynch to liquidate his account, and, in fact, the record clearly shows that he

actually requested that his account not be closed out. It is submitted that on the facts of this case, the jury's answers to Questions 1, 2, and 3 of the Trial Court's Charge provide no legal defense whatsoever to Merrill Lynch's right to recover Brooks' debit balance, and that, as a matter of law, Merrill Lynch was not "negligent" and its action or inaction was not the "proximate cause" of Brooks' loss. As stated by the court in *DuPont v. Neiman, supra* at 66:

> In the instant case, defendant [customer] makes no claim that plaintiffs did not follow his orders in the execution of his purchases and sales, nor does he charge that plaintiffs made any fictitious transactions, or violated any exchange rules in the *execution* of his orders. His only claim is that plaintiffs violated exchange rules in granting him credit *after the transactions had been made in accordance with his orders.* In effect, his argument is that the alleged 'illegality' in granting him credit vitiated the transactions made prior to the granting of credit. Cohen v. Rothschild, supra, is not authority for such an argument, nor have we found any decision that is.

This Court will find no authority for such a proposition in Brooks' Petition either.

2. Brooks Is Precluded From Complaining of Merrill Lynch's Actions or Inactions

A. Brooks Consented by Acquiescence

In answer to Question No. 7, the jury found that Brooks consented to Merrill Lynch's failure to make a margin call prior to May 2, 1973, as well as Merrill Lynch's failure to liquidate his account prior to May 9 and 11, 1973. The jury was instructed by the Court that "a person 'consents to' an

omission of another when, by his neglect, silence, or inaction, he fails to complain, with knowledge of the existence of a right to complain, for a period of time in excess of the time within which a person of ordinary prudence under the same or similar circumstances whould have complained." (R. 183). Because the trial court's definition of "consent" suggests waiver, estoppel, and ratification, all of these doctrines will be discussed, but without particular regard to their theoretical differences, since all three operate as a legal bar to Brooks' right to complain of the acts or omissions of Merrill Lynch in this case. There follows first a general discussion of the law of waiver, estoppel, and ratification, as described in *New York Jurisprudence,* and, secondly, a discussion of specific case authority arising out of securities and commodities transactions.

It has been said that "where acts are not performed in a timely manner by one person, another person who participates in such delay cannot take advantage thereof, since such participation constitutes a waiver." 21 N.Y. JUR. *Waiver* §95 (1961). Acquiescence, with knowledge of rights, has been held to be awaiver, and the waiver may result from acquiescence as well as from expressed consent. *See Shernoff v. Schimel,* 112 N.Y.S.2d 333, 342-43 (Sup. Ct. 1952). Acquiescence as a separate defense:

> Is dual in character in that it rests either upon implied ratification or upon equitable estoppel, the former applying when Plaintiff's conduct subsequent to the transaction complained of supports the conclusion that he has by his assent and acquiescence accepted and adopted it, and the other resting upon the principle that a plaintiff who has remained silent and negative when he had an opportunity and was under the duty to speak and act is estopped.

21 N.Y. JUR. *Ratification* § 85 (1961). Other definitions of estoppel include the term "acquiescence":

> It is well settled principle that he who fails to protest when there is a duty and opportunity to speak is deemed to have acquiesced and will not later be heard to complain. . . . When a party with full knowledge, or with sufficient notice of his rights and of all the material facts, freely does what amounts to a recognition or adoption of a contract or transaction as existing, or acts in a manner inconsistent with its repudiation and so as to affect or interfere with the relations and situations of the other parties, he acquiesces in and assents to it and is equitably estopped from impeaching it. . . .

21 N.Y. JUR. *Estoppel* § 35 (1961). As stated in 21 N.Y. JUR. *Estoppel* § 34 (1961): "Graphically stated, he who consents to the sowing is not to be allowed to deny the sower's right to reap."

Specifically with respect to the broker-customer relationship, the rule has been phrased thusly:

> A customer who wishes to repudiate an act of his broker must do so with reasonable promptness. How much time may be take for this purpose is not established by any fixed rule. It has been held in some cases that the disaffirmance must be made within a reasonable time; in others it must be made promptly; in still others, that it must be made immediately. It is clear, however, from the decisions that the customer may not delay very long after the wrongful act has been brought to his knowledge.

MEYER, THE LAW OF STOCKBROKERS AND STOCK EXCHANGES 416-17 (1931). *See also Burnham v. Lawson*, 118 App. Div. 389, 103 N.Y.S. 482 (Sup. Ct. 1907 (customer must repudiate within a "reasonable" time). Further examples of the application of this rule are numerous. In *Raisis v. Eisele*

& King, Libaire Stout & Co., 16 N.Y.2d 557, 250 N.Y.S.2d 834 (1965), the Court of Appeals of New York held that a customer ratified the action of his stockbroker in failing to timely disaffirm the broker's "cover" of one of the customer's short sales. In *Sica v. Gimma*, 175 N.Y.S.2d 779 (Sup. Ct. 1958), the court held that the customer ratified the acts of her broker when she received monthly statements clearly delineating all transactions and never complained to the firm about her account. She was precluded from belatedly so complaining at the courthouse. In *Hirsch & Co. v. Pattiz*, 19 App. Div. 2d 607, 241 N.Y.S.2d 124, 125 (Sup. Ct. 1963), the court held that whatever right the customer has to complain of the broker's failure to liquidate the account promptly upon its becoming undermargined was waived. At the time, the customer, although not coming up with the margin money requested, nevertheless asked the broker to "exercise as much discrimination in selling as possible," and "to extend as much consideration as possible." Further, the customer did not object to the subsequent liquidation of his account, which was set forth in detail on the written confirmation received by him. The court stated: "It is clear that whatever contract rights flowed to defendant by incorporation through reference of the rules of the exchange into the trading agreement . . . were unmistakably waived by him." *Id.*

In *Krinsky v. Whitney*, 54 N.E.2d 36 (Mass. Sup. Jud. Ct. 1944), the court held that the customer waived any right to rescind the margin agreement with his broker since he failed to act within a reasonable time to notify his broker of his intention to rescind. The Court stated:

> The highly speculative character of the transaction required prompt notice to the defendants [brokers]. He [customer] could not stand by and withhold

> deciding until it appeared whether the account would prove profitable or otherwise, and in the meanwhile trade on the account at the expense of the defendants. We hold on this record, that the plaintiff by his unreasonable delay lost any right to rescind the agreement and recover what he had paid to the defendants. There was no error in directing verdicts for the defendants.

Id. at 40. Further, in the opinion in *Krinsky* the court noted that the parties agreed that the broker failed to liquidate the customer's account within a reasonable time after the undermargining. The court stated, however, that the customer could no recover from the broker for this failure to liquidate "unless he first proved that he ordered the defendants [brokers] to close the account." Until that event occurred there was no duty on the part of the defendants to close out the account." *Id.*

In *Craig v. Pierce*, 231 App. Div. 159, 246 N.Y.S. 573 (Sup. Ct. 1930), the court held that the customer waived any right to require the broker to liquidate his commodity account at a certain price when the customer, clearly with knowledge of the right to complain, failed to do so within a reasonable time. The customer, in attempting to explain to the broker the reason for his silence, stated that, *inter alia,* he kept silent because he "thought the commodity would rise rapidly and [he] could dispose of it at the same price without any mention of the matter." *Id.* at 579. The court stated that: "One who takes chances with the market in the manner shown by the correspondence in this case should accept the result and not wait until it is too late for anyone to remedy the condition and then attempt to place the loss on others. *Id.* at 579-80.

To the same effect, and giving a clear statement of the law of ratification based on silence by the customer is *Leviten v. Bickley, Mandeville & Wimple, Inc.*, 35 F.2d 825 (2d Cir. 1929).

Customer, Leviten, claimed that he had an oral agreement with the brokerage firm not to liquidate his short position in eleven cars of butter for December delivery until he had notice of the necessity of maintenance margin and a reasonable time to comply therewith. The brokerage firm did not deny that it failed to comply with Leviten's wishes, but alleged that he ratified its action by his subsequent conduct. The court explained the doctrine of ratification:

> Ratification has been defined as the subsequent adoption and affirmance by one person of an act which another, without authority, has previously assumed to do for him while purporting to act as his agent. By such ratification the principal absolves the agent from responsibility for loss or injury growing out of the unauthorized transaction, and gives him the same rights to compensation, reimbursement, and indemnity as he would have had, if his act had been previously authorized. . . .
>
> Ratification may be proved, not only by an express assent, . . . but also by implication from the principal's acquiescence or failure to dissent within a reasonable time after being informed by the agent of what he has done, as in *Law v. Cross*, 66 U.S. (1 Black) 533, 539, . . . 'If the price had risen, and Cross had sold it, Law might justly have claimed the profit; and when informed by his agent of what he had done, if the principal did not chose to affirm the act, it was his duty to give immediately information of his repudiation. He cannot by holding his peace, and apparent acquiescence, have the benefit of the contract if it should afterwards turn out to be profitable, and retain a right to repudiate it if otherwise.
>
> The principle of ratifiction has frequently been applied in litigation involving the unauthorizd purchase or sale of stock held on margin by brokers,

> though usually the principal's silence has been accompanied by some affirmative act which strengthens the inference of ratification. . . . But instances are not wanting where, as in *Law v. Cross* the inference arises solely from delay in repudiation.

Id. at 827. The court then had occasion to note the extreme importance of immediate repudiation or complaint by a customer when he is dealing in fluctuating commodity futures:

> The situation was one where delay by the principal in deciding on his course of conduct, if permitted by law, would give him the benefit of a change in the market if it moved in his favor, and put the loss on the agent if it went against him. . . . There was no showing that the appellant did in fact rely upon Leviten's silence; but this is unnecessary, for the doctrine of ratification is independent of estoppel. However, the fluctuating market price of the commodity with respect to which the parties were dealing demonstrates the reasonable foundation of the requirement that the principal act promptly in electing whether to affirm or reject the agent's purchase made on his behalf. The principal by his silence should not be permitted to retain the chance to speculate at his agent's risk.
>
> Ordinarily the question whether a principal has ratified by acquiescence for an unreasonable time after being informed of the agent's unauthorized act is a question of fact for the jury. But the evidence may be such as to make it a question of law for the court.

Id. at 828.

From Brooks' own testimony it is established that he was a sophisticated commodity futures trader, capable of ratifying his broker's actions or omissions (Tp. 206). Brooks had made "independent studies" of the commodity futures market since 1960 (Tp. 186); since 1960 he kept "point and figure" charts to plot price movement of futures contracts (Tp. 186-87); had

priced a seat on the Chicago Board of Trade (Tp. 191-92); was one of the largest and most active commodity futures traders in the Dallas-Republic office of Merrill Lynch (Tp. 198); traded in sufficient volume to be required to submit reports to the Department of Agriculture (Tp. 192-93); had full knowledge of commodity futures margin requirements (Tp. 198); and was reported by credit services to be "among the most wealthy men in Dallas" (Px-22). Specifically, with respect to his trading in July 1973 Soybean Meal contracts, Brooks was in the Dallas-Republic office of Merrill Lynch about one hour per day reviewing market activity (Tp. 189); he relied on his own judgment in buying and selling contracts and all orders in this case were unsolicited (Tp. 187, 188); he knew his margin position and the status of his account everyday from April 12, 1973, to the liquidation of his position and at a given point during a day, notwithstanding the failure of Merrill Lynch to give a formal margin call prior to May 2, 1973 (Tp. 188-89, 190, 204-06, 371); Davis, Merrill Lynch's Dallas-Republic office manager, advised Brooks to use formal stop-loss orders to curb losses in an adverse market, but Brooks refused, terming such devices "poor trading mechanisms" (Tp. 195-97); when Davis confronted Brooks with the undermargined condition of his account, Brooks asked for time to raise the margin money and that he be allowed to maintain his position (Tp. 90, 142, 144, 203, 377); at no time asked to be liquidated (Tp. 69); and he recognized that he was at all times liable to Merrill Lynch for the debit balance in his account upon liquidation (Tp. 202, 206), and he never disaffirmed any action or inaction by Merrill Lynch with respect to his account and never complained that Merrill Lynch breached any legal or contractual duties or CBT rules or regulations (Tp. 375, 377, 378). Of

particular importance is Brooks' response to a critical question posed by the trial court:

> THE COURT: When did you first know in your mind that they were violating the rules?
>
> A. (Brooks): I knew it all along, because, you know, I saw they were—I was well aware of what the rules and regulations were. (Tp. 378).

Therefore, the jury finding (in response to an issue properly framed under New York or Texas law) that Brooks consented by acquiescence to the handling of his account by Merrill Lynch is amply supported by Brooks' own testimony. Under New York law or Texas law, as held by the trial court (R. 196). Brooks is precluded from defending on the bases urged by him because of his failure to disaffirm timely alleged improper acts or omissions of his broker.

B. Brooks Affirmatively Ratified Merrill Lynch's Actions

Apart from the Commodity Account Agreement, Merrill Lynch sued Brooks on the May 7, 1973, letter from Brooks to Davis (Px-4), in which Brooks acknowledged the following:

> Dear Mr. Davis:
>
> I hereby acknowledge the unsecured amount of money owed to Merrill Lynch, Pierce, Fenner & Smith Inc. Per our conversation in your office on May 2, 1973, I agree to pay to Merrill Lynch Pierce, Fenner & Smith Inc. the total amount of this indebtedness.
>
> As of this date the amount has not been determined. I agree that when the amount is determined I will sign a similar letter in which the amount of indebtedness is specified.
>
> I also agree to pay Merrill Lynch, Pierce, Fenner & Smith Inc. interest at the rate of 7½% on the

> unpaid balance until the total amount of the indebtedness has been paid in full.
>
> Very truly yours,
>
> /s/ E. B. Brooks, Jr.
> E. B. Brooks, Jr.
>
> /s/ V. Goodman
> Witness
>
> Attested to:
>
> /s/ Rhoda Weisman
> Notary Public
>
> Date: May 7, 1973.

Not only did the above-quoted letter of indebtedness provide Merrill Lynch with an independent basis for recovery, but, as found by the trial court: "Pursuant to general principles of Texas law, Brooks' letter of May 7 constitutes a ratification of any negligent or wrongful conduct by Merrill Lynch in the handling of his account before that date" (R. 196). Thus, the trial court properly found that Brooks ratified all prior allegedly wrongful acts or omissions of Merrill Lynch by his reaffirmation of debt on May 7, 1973. However, Brooks has argued that he did not have knowledge of the facts, and of the *law*, required for ratification. It is submitted that the response of Brooks to the trial court's question that he knew "all along" that he had a right to complain of Merrill Lynch's failure to give him a margin call prior to May 2, 1973, and its failure to liquidate his account prior to May 9 and 11, 1973 (Tp. 378), establishes that Brooks did indeed have full knowledge of the facts, and even of his alleged legal rights to complain, at the time he signed the letter of indebtedness.

Brooks had argued at one point in the trial that "the only purpose of that letter was to allow me to retain discretion

in my account and to carry it forth whereby I wouldn't have such a large loss." (Tp. 367). Thus, Brooks implied that he had an agreement with Merrill Lynch that upon his execution of the letter of indebtedness, he could have a "margin-free" ride through the maturity of the Soybean Meal contracts in consideration for his agreement to pay any resulting indebtedness (Tp. 409-10). However, on close questioning, Brooks admitted that there was no such agreement:

> Q. (By Mr. Vial): Then it is your sworn testimony in the United States District Court that you made an agreement with Dick [N.R.] Davis that Merrill Lynch would take the risk of all of this market going to make maybe multi-millions of dollars of losses, but you made this agreement with him that your account would be carried at Merrill Lynch's risk until delivery date —is that right?
>
> A. (By Brooks): We had no agreement.
>
> Q. What?
>
> A. We had no agreement.
>
> Q. I thought you just testified to that. Didn't you just testify in your answer to Counsel's question that— "This is my position in this court"—
>
> A. We did not have an agreement—
>
> THE COURT: Just a minute. It is your position that you did not have an agreement?
>
> A. We did not have an agreement.

(Tp. 380-83).

According to Brooks, after the letter was forwarded to New York, Davis informed Brooks that New York had not accepted the last ditch effort to carry Brooks' account into July without full margin and Davis began to liquidate Brooks' position (Tp. 204). Thus, in Brooks' own words: "There was no agreement" whereby Merrill Lynch would permit Brooks account to continue without full margin. The Dallas-Republic office did send the letter of indebtedness to its New York office in an effort to pacify the exchange, but, in Brooks' own words: "I see no evidence that it . . . satisfied the Chicago Board of Trade requirements" (Tp. 383). Accordingly, New York reported to Davis that "this would not be acceptable . . . to carry the account" (Tp. 204).

When combined with the jury finding of consent, the letter of indebtedness establishes as a matter of law that Brooks impliedly affirmed and ratified Merrill Lynch's handling of Brooks' account to that date. The authorities, rules, and contract provisions already discussed support Merrill Lynch's action in liquidating Brooks' account on May 9 and 11, 1973. There is nothing further about which Brooks could complain.

Brooks' however, does complain that the trial court's finding of ratification via the letter of indebtedness constitutes a denial of trial by jury, because the evidence with respect to the letter raised a fact issue, and no such issue was submitted to the jury. Even if this Court agrees with Brooks that the evidence did raise a fact issue on ratification via the letter of indebtedness (Merrill Lynch says the evidence conclusively demonstrates ratification as a matter of law); nevertheless, under Rule 49(a), Federal Rules of Civil Procedure, Brooks waived his right to a trial by jury on such issue, because he failed to request such an issue and did not object to the trial court's failure to submit one. Rule 49(a) provides:

> (a) Special Verdicts. The court may require a jury to return only a special verdict in the form of a special written finding upon each issue of fact. In that event the court may submit to the jury written questions susceptible of categorical or other brief answer or may

> submit written forms of the several special findings which might properly be made under the pleadings and evidence; or it may use such other method of submitting the issues and requiring the written findings thereon as it deems most appropriate. The court shall give to the jury such explanation and instruction concerning the matter thus submitted as may be necessary to enable the jury to make its findings upon each issue. *If in so doing the court omits any issue of fact raised by the pleadings or by evidence, each party waives his right to a trial by jury of the issue so omitted unless before the jury retires he demands its submission to the jury. As to an issue omitted without such demand the court may make a finding; or, if it fails to do so, it shall be deemed to have made a finding in accord with the judgment on the special verdict.*

(Emphasis added.)

Because Merrill Lynch raised the issue of ratification by the letter in its portion of the Pre-Trial Order (R. 160, 161), and because, as above set out, the evidence (if it did not conclusively show ratification) at minimum raised a fact issue as to ratification via the letter, under Rule 49(a) the trial court was authorized to act as trier of fact and enter its finding without submitting the issue to the jury, in the absence of a request for such an issue by Brooks or an objection to the failure to submit it. Even if the trial court had not found ratification by Brooks' execution of the letter of indebtedness, Rule 49(a) would require this Court to deem such issue as having been found in accordance with the judgment:

> [T]he failure of a party to request the court to submit any issue to the jury which the court may have overlooked is a waiver by that party of his right to trial by jury thereon. . . . And 'as to an issue omitted without such demand, the court may make a finding.'

> When a party fails to request the court to submit an issue and the court omits to make an express finding, the rule goes further to support judgment on special verdicts by implying findings in accord with the judgment rendered.

5A J. MOORE, MOORE'S FEDERAL PRACTICE § 49.03[4], at 2215-17 (1975). *See also Smallwood v. Pearl Brewing Co.*, 489 F.2d 579, 606 (5th Cir. 1974).

Although Brooks requested several issues which the trial court did not submit (Supp. Record), and Brooks objected to issues submitted, including Question 7 (pertaining to "consent" by acquiescence) (Tp. 422-29), he never requested (or objected to the failure to submit) an issue as to whether Brooks ratified Merrill Lynch's handling of his account through May 7, 1973, as a result of his execution of the letter of indebtedness, reaffirming his liability for the debit balance in his account. Therefore, Rule 49(a) authorized the Trial Court to make its fact finding, which the court did in favor of Merrill Lynch. Had the Trial Court not done so, the Rule would require this Court to deem such a finding as having been made.

3. No Error Was Committed in the Submission of the Case to the Jury

In his Petition, Brooks has argued that the Trial Court failed to submit material issues to the jury. The requested issues which the Trial Court did not submit may be grouped as follows: (a) breach of contract issues regarding alleged violations of Chicago Board of Trade rules; (b) negligence and fiduciary duty issues pertaining to Brooks' allegation that Merrill Lynch failed to disclose when and under what circumstances it would liquidate his account for failure to meet margin requirements;

and (c) negligence, breach of contract and fiduciary duty issues regarding Merrill Lynch's failure to give Brooks a formal margin call prior to May 2, 1973. For purposes of argument these groups will be discussed separately below.

A. Breach of Contract Issues

Even though the material facts were not in dispute (only the legal consequences flowing therefrom), Brooks requested the trial court to inquire of the jury whether Merrill Lynch carried the account of Brooks without proper and adequate margin and whether such failure was a breach of the Commodity Account Agreement (Requested Issues 3A and 3B); and whether Merrill Lynch breached the Commodity Account Agreement by failing to comply with rules, regulations, customs, and usages of the CBT (Requested Issues 7A and 7B). In essence, these requested issues were formulated by Brooks in order to submit his theory that Merrill Lynch not only violated rules, regulations, and customs and usages of the CBT, but that, by virtue of such violations, Merrill Lynch also breached the Commodity Account Agreement. The basis for Brooks' breach of contract theory is that the Commodity Account Agreement incorporated the rules, regulations, and customs and uages of the CBT by reference, and they thereby became terms of the contract, applicable to both parties equally. This, of course, is erroneous. The Commodity Account Agreement (Px-1) provides that:

> In consideration of your [Merrill Lynch's] acting as broker for the undersigned, I [Brooks] hereby consent and agree that:
>
> Any and all transactions shall be subject to the constitution, rules, and regulations, customs and usages of the exchange or market (and its clearing house, if any), where executed.

There is no blank for a representative of Merrill Lynch to sign. Acceptance by Merrill Lynch is accomplished upon performance as a broker. The obligations and agreements undertaken are exclusively those of Brooks. His consent that all transactions shall be subject to the rules of the exchange where the order is executed is nothing more than his assent to the method of execution of transactions on the floor of the exchange. As discussed below, the CBT margin rules are for the benefit of the brokers to insure broker solvency, and are in no way designed to protect the individual customer. But even if it could be said that Merrill Lynch violated a rule, regulation, or custom and usage of the CBT, the Commodity Account Agreement specifically says that:

> You shall have the *right* whenever *in your discretion* you consider it necessary for your protection, or in the event that a petition in bankruptcy, or for the appointment of a receiver, is filed by or against me, or an attachment is levied against my account(s) with you, or in the event of my death, to sell any or all commodities in my account(s) (either individually or jointly with others) to buy any or all commodities which may be short in such account(s) and to close any or all outstanding contracts all without demand for margin or additional margin, notice of sale or purchase, or other notice or advertisement, and any such sales or purchases may be made at your discretion on any exchange or other market where such business is then usually transacted, and on any such sale you may be the purchaser for your own account; it being understood that a prior demand, or call, or prior notice of the time and place of such sale or purchase shall not be considered a waiver of your right to sell or to buy without demand or notice as herein provided; and it being further understood that I shall at all times be liable for the payment of any debit balance owing in my account(s) with you upon

> demand, and that I shall be liable for any deficiency remaining in any such account(s) in the event of the liquidation thereof in whole or in part by you or by me. (Emphasis added.)

Thus, Merrill Lynch had no *duty* to liquidate Brooks' account (under the Commodity Account Agreement and CBT Rule 209 and Regulation 1822, ¶ 14) at anytime after it became undermargined. So, "carrying" Brooks' account in an undermargined condition (which is only semantically different from a failure to liquidate), even if it could be said to be violative of CBT Rule 210, could not be a breach of the Commodity Account Agreement. Further, Brooks has never pleaded or presented evidence that Merrill Lynch waived any of *its* rights under CBT rules and regulations and the Commodity Account Agreement. From the record it is apparent that the trial court properly treated alleged violations of CBT rules and breaches of contract on undisputed material facts, as issues of law (Tp. 152), and correctly refused to hold that violations of CBT rules, if any, gave Brooks a defense (see pp. 10-13 *supra*), or that Merrill Lynch's handling of the Brooks' account breached any provisions of the Commodity Account Agreement.

Finally, assuming that the Trial Court committed error in omitting material issues from its charge, such error is clearly harmless error under Rule 61, Federal Rules of Civil Procedure, because both the jury and the Trial Court found that Brooks ratified all alleged rule violations and contract breaches by Merrill Lynch.

B. Issues Regarding Alleged Failure to Disclose Procedures in the Event of Failure to Meet Margin Requirements

Brooks contends that Merrill Lynch failed to disclose when

and under what circumstances his account would be liquidated upon failure to meet margin requirements, and that such alleged failure to disclose was negligence and/or a breach of fiduciary duty owed to him by Merrill Lynch. He complains that the trial court committed reversible error in not submitting the material fact issues underlying this defensive theory to the jury. It is submitted that the evidence conclusively established that Merrill Lynch did not fail to disclose the procedure to be followed upon undermargining, and that Brooks was well aware of all alternatives available to him and of the consequences of each. The Commodity Account Agreement very clearly set out Merrill Lynch's rights to liquidate Brooks' account if it became undermargined, even without the necessity of a margin call or any notice whatsoever (Px-1). Brooks admitted that he signed the Commodity Account Agreement (Tp. 202). CBT Rule 209 and Regulation 1822, ¶ 14, as interpreted by the courts (see *supra* at pp. 14-16), are in harmony with the Commodity Account Agreement in giving Merrill Lynch broad rights to require additional margin deposits and to liquidate undermargined accounts, and in specifying that the forbearance to exercise such rights will not affect the customer's continuing liability for any debit balance in his account. Brooks stated that he was familiar with the rules and regulations of the CBT (Tp. 378). In addition, the Commodity Account Agreement states that "a prior demand [for margin], or call, or prior notice of the time and place [of liquidation] shall not be considered a waiver of your [Merrill Lynch's] right [to liquidate an undermargined account] without demand or notice." Brooks has never alleged in the trial court or in this Court that Merrill Lynch waived its rights under CBT rules and regulations or the Commodity Account Agreement. The Court is also referred to

the New York cases cited and discussed *supra* at pp. 17-19, which hold that even when the broker gives its customer misinformation as to the time, place, and circumstances of liquidation of an undermargined account, the customer may not complain.

Therefore, it is submitted that, as a matter of law on the undisputed facts, Brooks knew that Merrill Lynch had the right to liquidate his account at any time, or *not* to do so, in its discretion; so, he may not claim breach of fiduciary duty or negligence because Merrill Lynch bent over backward to salvage Brooks' position or cut his losses — something he refused to do himself.

C. Issues Regarding the Late Margin Call

Brooks contends that the Trial Court committed reversible error in not submitting issues to the jury inquiring as to whether Merrill Lynch's failure to give Brooks a formal margin call prior to May 2, 1973, was negligence, a breach of contract or fiduciary duty, and of CBT Rules and regulations. CBT rules and regulations and provisions of the Commodity Account Agreement giving Merrill Lynch the unqualified right to liquidate an undermargined account (without notice or call) have been previously discussed. These rules and contract provisions clearly eliminate any defense Brooks might otherwise have had based on a late margin call. Further, the trial court did submit issues on the margin call question. In answer to Question No. 4, the jury found that Merrill Lynch was negligent in failing to give Brooks a margin call prior to May 2, 1973 (R. 180). However, in answer to Question No. 5, the jury found that Brooks would not have liquidated his account prior to May 2, 1973, even if he had received a margin call (R. 181). Of

course, the reason the jury answered Question No. 5 as it did is that Brooks admitted he knew the status and condition of his account at all times, that he could have closed out his account and cut his losses at any time, but did not. Thus, the undisputed evidence and the jury's answer to Question No. 5 shows that a late margin call did not deprive Brooks of *notice* of the undermargined status of his account; nor did a late margin call cause him to miss an opportunity to cut his own losses.

Finally, the jury, the Trial Court and the Fifth Circuit found that Brooks ratified all alleged rule violations, negligent acts or omissions, and breaches of contract or fiduciary duty by Merrill Lynch by his acquiescence and his execution of the May 7, 1973, letter of indebtedness. Under Rule 61, Federal Rules of Civil Procedure, any error of the Trial Court in failing to submit further issues on the late margin call question was harmless.

4. Regulation "T" Cases Distinguished

As has been noted above, Brooks misplaces reliance on cases such as *Miller v. New York Produce Exchange, supra,* which discussed a commodities broker's duty to the *commodities exchange* and not the broker's duty to its customer under exchange rules. This is a key area of confusion in Brooks' Petition. But there is another misleading aspect to Brooks' contentions. Brooks continues to rely (although not quite as heavily in his Petition as in his Brief and argument in the Court below) on *Goldenberg v. Bache & Co.*, 270 F.2d 675 5th Cir. 1959), and *Gordon v. duPont Glore Forgan, Inc.*, 487 F.2d 1260 (5th Cir. 1973). Actually, both of these cases illustrate ratification by a securities customer by acquiescence and failure to timely disaffirm a broker's acts or omissions.

However, because the Fifth Circuit in *Goldenberg* and *Gordon* also refused to permit the brokers to recover on their counterclaims because of their own violations of Regulation "T". Brooks has cited both cases as authority for urging this Court to simply leave the parties where they were prior to resort to the Courts. Although these cases are distinguishable on other grounds, it should be noted at the outset that the public policy behind Regulation "T" and the federal securities laws generally has absolutely no bearing on this case. Further, Regulation "T" speaks only to initial margin, and in no way purports to regulate maintenance margin. *See Carras v. Burns*, 516 F.2d 251, 260 n.6 (4th Cir. 1975). Neither *Goldenberg* nor *Gordon* was a commodity futures case and neither involved New York law. In fact, no state law was applied at all with respect to the brokers' counterclaims. Federal law was applied to determine the effect of the brokers' acts or omissions. The alleged violations of duty by the brokers in *Goldenberg* and *Gordon* were more than violations of rules or regulations of commodity or stock exchanges, but were violations of Regulation "T", which has the force of law, pursuant to the Securities Exchange Act of 1934. The case at bar is not a Regulation "T" case. No violations of federal securities law were alleged or proved. In fact, no violations of any provision of the Commodity Exchange Act were proved. Only state law is relevant herein.

As the Comptroller General reported to Congress in 1974 when Congress was considering amending the CEA:

> The need for CEA [the Commodity Exchange Authority] or another Federal agency to have authority to establish commodity margin requirements has been the subject of much controversy and misunderstanding, primarily because commodity margins have been compared with security margins, when, in fact, they are not comparable. Commodity margin is the amount of money which the buyer or seller of a futures contract deposits with its [Futures Commission Merchant] FCM to guarantee performance on the contract. The margin is required to protect the FCM against losses incurred by a customer due to adverse price movements. It is not a partial payment on the futures contract. The FCM has to make settlement each day for profits or losses incurred by its customers. The margin money, plus or minus any gains or losses on the customer's trades, is returned to the customer when his account is closed. In a normal market, commodity margins are generally less than 10 percent of the value of the contracts bought.
>
> Security margin is directly related to the amount of credit a broker is permitted to extend to customers for buying securities. This amount of credit is regulated by the Board of Governors of the Federal Reserve System and is 50 percent or more of the value of the securities bought.

INTERIM REPORT OF COMPTROLLER GENERAL ON THE COMMODITY EXCHANGE AUTHORITY AND ON COMMODITY FUTURES TRADING, 120 CONG. REC. 7527 (daily ed. May 9, 1974). *See also id.* at 7525:

> The idea of giving the futures trading authority to SEC was rejected by the House Committee on Agriculture and others as having little advantage and many disadvantages. The principal advantage was that SEC has an existing regulatory structure and is supervising some brokerage firms that also trade in the commodity futures markets. The overriding disadvantage was the pronounced difference between CEA and SEC in fundamental orientation and purpose, which would pose different regulatory problems. For example, a futures contract is not a security; hence, the laws applicable to securities would not apply to futures contracts.

Margin requirements set by commodity exchange rules are established primarily *to protect the solvency of brokers* by assuring adequate security for the performance of the futures contract, for which the broker is responsible to the exchange, which the broker is responsible to the exchange, whether the broker's customer defaults or not. (Tp. 235-36). Therefore, since such rules were not promulgated for the protection of customers, they create no civil right of action and no defense to a broker's action for debt. *See Carras v. Burns, supra* at 260. *See also Rosee v. Board of Trade of City of Chicago*, 311 F.2d 524, 525 (7th Cir. 1963); U.S. DEP'T OF AGRICULTURE, MARGINS, SPECULATION & PRICES ON GRAIN FUTURES MARKETS 176, 189, 190-200 (1967); Wolff, *Comparative Federal Regulation of the Commodities Exchanges & The National Securities Exchanges*, 38 GEO. WASH. L. REV. 223, 242-44 (1969) ("there is no indication that government-imposed margins could effectively serve functions other than protection of broker solvency, a goal successfully maintained under the present industry structure"); Note, *Civil Liability of a Broker for Failure to Enforce Margin Requirements*, 10 WILLAMETTE L.J. 72, 85 (1973). This approach was obviously adopted by Congress in 1974 when in the CFTCA, it expressly refused to exert government regulation over margin transactions on commodities exchanges. *See* 7 U.S.C. §§ 7a(12) & 8a(7)(c) (Supp. 1974). Instead, market and broker solvency was and is protected via stringent minimum financial requirements on futures commission merchants and daily settlement and reporting procedures *at the contract market level*, not in the area of broker-customer margins. *See* 7 U.S.C. §§ 6f, 7a(9) (Supp. 1974); 17 C.F.R. § 1.17 (1976).

Therefore, the margin rules of commodity exchanges do not now, and certainly did not prior to the CFTCA, have the force of law as do rules and regulations promulgated by the Securities and Exchange Commission or the Federal Reserve Board pursuant to federal securities laws. Brooks is accordingly unaided by overriding Congressional purposes reflected in such laws.

CONCLUSION

For the foregoing reasons, Respondent respectfully requests that the Petition for Writ of Certiorari be denied.

Respectfully submitted,

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PROOF OF SERVICE

Two copies of this Brief in Opposition have been served upon Petitioner, E. B. Brooks, Jr., by hand-delivering same to his attorney of record, Mr. B. Thomas McElroy, WHITE, McELROY, WHITE, SIDES & RECTOR, 2505 Republic National Bank Tower, Dallas, Texas, 75201, on this .... day of August, 1977.

PAUL D. SCHOONOVER